IN THE

# Supreme Court of the United States

October Term, 1952

No. 290



ERNEST A. WATSON and M. GLADYS WATSON,
*Petitioners,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

**Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit and Brief in Support Thereof.**

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COMMISSIONER OF INTERNAL REVENUE,

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## Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

*To the Honorable the Supreme Court of the United States:*

Your petitioners respectfully show:

### Statement of the Matter Involved.

The issue presented to this Court is whether a portion of the sale price of an orange grove should be allocated to the unmature oranges on the trees and treated as ordinary income, where there has been a sale of land and trees with an unmature crop of oranges thereon for a lump sum consideration; or whether the sale in its entirety should be treated as coming within the purview of Section 117(j) of the Internal Revenue Code (Title 26,

U. S. C. A., Sec. 117) and the gain therefrom taxed as capital gain.

The petitioners are husband and wife who filed a joint individual income tax return for the year 1944 with the Collector of Internal Revenue at Los Angeles, California. [R. 57.] The wife, M. Gladys Watson, and her two brothers each owned an undivided one-third interest in a 115-acre tract of land, of which 110 acres were a navel orange grove and five acres were a peach orchard. [R. 57.] This property was known as the Dofflemyer Grove and is situated near Exeter, Tulare County, California. [R. 57, 75.] The co-owners had acquired the property on December 31, 1941, upon dissolution of a family corporation. [R. 20.] However, the family had supervised or managed the ranch since the year 1912 or 1913. [R. 21, 74.] On August 10, 1944, the co-owners entered into an escrow agreement for the sale of this property, together with the improvements, water rights and equipment thereon, for a lump sum consideration of $197,100.00. [R. 57, 78.] Petitioner, M. Gladys Watson, reported the sale of her one-third interest on the joint 1944 income tax return of husband and wife as a sale of assets falling within the purview of Section 117(j) of the Internal Revenue Code, and treated the gain thereon as capital gain. [R. 30.]

Pursuant to the escrow agreement of August 10, 1944, $10,000.00 in cash was paid by the purchaser on that date and the balance of the purchase price was paid and the deed to the property was delivered on September 1, 1944. [R. 78; Ex. 5.] The original agreement required the seller to furnish a policy of title insurance in the amount of $197,100.00. Documentary stamps were attached to the deed in the amount of $217.25, representing

the tax under Section 3482 of the Internal Revenue Code, based upon the entire consideration paid for the property. (55 cents for each $500.00 or fractional part of the consideration or value of real property conveyed.) [R. 78, Ex. 5.]

At the time of the sale the orange trees had upon them green, unmature fruit which would not begin to mature for a period of at least three months thereafter. [R. 58, 81, 113.] Picking would then start and continue under the prorate system through January of the following year. [R. 83, 84.] The sales agreement made no mention of a crop of oranges on the trees and treated the sale in its entirety as a sale of real property, making no allocation of the sale price. [R. 78, Ex. 5.]

Petitioner, M. Gladys Watson, and her brothers operated the Dofflemyer Grove under a partnership agreement. [R. 74, 75.] Their occupation was farming and fruit growing. [R. 74, 121.] They were not in the business of selling orange groves. [R. 74, 75.] Neither was it their business to sell unmature fruit on the trees. They had never made such a sale prior to the sale here in question, and it was entirely out of their contemplation to have sold their unmature fruit on the trees either on August 10 or September 1 of the year 1944 or any other year. [R. 94, 95, 122, 123.]

During the year 1944 and in prior years in California under the prorate system, there was no buying of fruit on the trees. [R. 95.] At the date of the sale the fruit on the trees would have had no value if picked. [R. 94.] It was small, green and pulpy, and lacked the required amount of soluble solids and acids. [R. 81, 82.] The petitioner, M. Gladys Watson, and her brothers in operating their grove followed the procedure of selling picked,

ripe oranges through the California Fruit Growers Exchange. This is a marketing organization which sells the pooled fruit of many growers in the eastern markets, and remits to each grower his proportionate part of the average selling price received for the pool. [R. 87, 88.]

The United States Tax Court allocated $40,000.00 of the purchase price to the unmature fruit and held that this amount represented ordinary income and was not to be treated as gain from the sale of capital assets within the purview of Section 117(j) of the Internal Revenue Code. [R. 31.] The Court of Appeals for the Ninth Circuit affirmed upon the ground that the unmature fruit represented property held by the petitioner primarily for sale to customers in the ordinary course of her trade or business and, therefore, that the sale was not within the scope of said Section 117(j). The Appellate Court further stated that assuming that the decision to sell the grove as a unit made the holding of the unmature crop a holding for sale not in the ordinary course of business, in this event the crop had not been so held for a period in excess of six months, inasmuch as the decision to sell was made in April or May and the sale occurred in September. The issues presented by this petition involve the correctness of these holdings by the Court of Appeals for the Ninth Circuit.

## Jurisdictional Statement.

The Supreme Court has jurisdiction to review the judgment here in question on the following grounds. The original proceeding was brought in the Tax Court of the United States and a decision was rendered by such court. Petitioners in due time filed a petition for review of said decision with the Court of Appeals for the Ninth Circuit,

which in turn rendered its decision. The statutory authority conferring jurisdiction is Section 1141(a) of the Internal Revenue Code. (Title 26, U. S. C. A., Sec. 1141.) This section provides that the Courts of Appeals shall have exclusive jurisdiction to review the decisions of the United States Tax Court; and the judgment of such Courts of Appeals shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code. The issues presented by this appeal are primarily questions of law involving a construction of the meaning of Section 117 of the Internal Revenue Code and are proper matters for review.

## The Question Presented.

The principal issue is, when a farmer sells an orange grove which he has held and operated many years, with unmature fruit on the trees, for a lump sum consideration, whether the unmature fruit on the trees is a part of the real property used in the taxpayers' trade or business held for more than six months and comes within the purview of Section 117(j) of the Internal Revenue Code, or whether the unmature fruit represents property held primarily for sale to customers in the ordinary course of the taxpayers' trade or business.

A second issue is whether the holding period for such property was a period in excess of six months. As an alternative ground for its decision the Court of Appeals for the Ninth Circuit stated that the holding period of the green fruit began on the date it became the intention of the parties to sell the grove as a unit, and that therefore the property had been held only from May to September, less than six months. [R. 135, 136.]

## Reasons Relied Upon for Allowance of Writ.

The decision of the Court of Appeals is in conflict with decisions of the Courts of Appeals for two other circuits on the same matter. (Supreme Court Rule 38, par. 5(b).) The matter presented in both of those cases is the proper treatment for income tax purposes, of the sale proceeds of agricultural property sold as a unit for a lump sum, where at the time of sale such agricultural property had upon it an unmature, unsevered crop.

The case of *McCoy v. Commissioner of Internal Revenue*, 192 F. 2d 486, involved a farmer who owned farming land for more than six months and had used the same in his business as a farmer. He sold the farming land at a time when it had an unmature growing wheat crop upon it. The Court of Appeals for the Tenth Circuit held that the crop was a part of the realty and the gain realized thereon was to be treated as capital gain within the purview of Section 117(j)(1) of the Internal Revenue Code.

The second case, *Owen v. Commissioner of Internal Revenue*, 192 F. 2d 1006, involved a fruit grower engaged in the business of growing and selling citrus fruits in Florida. She sold an orange grove held by her for a period in excess of six months, together with equipment and unmature, unsevered fruit on the trees, for a lump sum consideration. The Court of Appeals for the Fifth Circuit held that the unmature fruit was to be treated as a capital asset and that the profit on the sale was to be taxed along with the land as a long term capital gain.

The Court of Appeals for the Ninth Circuit in the instant case, while assuming the unmature fruit to be real property, held nevertheless that the same was real property of a character different from the land and trees, *i. e.*, property held primarily for sale to customers in the ordinary course of trade or business, and that the gain thereon was to be treated not as capital gain but as ordinary income.

The two decisions in the Fifth and Tenth Circuits are not distinguishable from the case at bar. A conflict of decisions exists which should be resolved by this Honorable Court.

Petitioner submits that the issue decided by the Court of Appeals for the Ninth Circuit is an important question of federal tax law. For taxable years subsequent to December 31, 1950, Section 117(j) as amended by Section 323 of the Revenue Act of 1951 specifically provides that upon the sale of land with an unharvested crop the gain from such sale shall be treated as capital gain. However, respecting sales of agricultural land with unmature crops made in taxable years ending on or prior to December 31, 1950, the tax liability of sellers is uncertain. Such uncertainty will only be dispelled by a decision of this Court.

Wherefore, your petitioners pray that a writ of certiorari issue under the seal of this Court, directed to the Court of Appeals for the Ninth Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings

of said Court of Appeals had in the case numbered and entitled on its docket No. 12982, Ernest A. Watson and M. Gladys Watson, Petitioners, vs. Commissioner of Internal Revenue, Respondent, to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Court of Appeals be reversed by this Honorable Court, and for such further relief as it may deem proper.

Dated: August 22, 1952.

Respectfully submitted,

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COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

### The Opinion Below.

The opinion of the United States Court of Appeals for the Ninth Circuit is reported in 197 Federal Reporter 2d 56. (Advance Sheets, August 4, 1952.) The opinion is also printed in full in the record. [R. 132-137.]

### Jurisdiction.

The jurisdiction of this Court is invoked under Section 1141(a) of the Internal Revenue Code. (Title 26 U. S. C. A., Sec. 1141.) The Court of Appeals for the Ninth Circuit in this case reviewed and affirmed the decision of the Tax Court of the United States. The affirming decision is subject to review by the Supreme Court of the United States upon certiorari. The decision of the Court of Appeals for the Ninth Circuit conflicts with decisions of the Courts of Appeals for the Fifth

Circuit and for the Tenth Circuit on the same matter. (Supreme Court Rule 38(5)(b).)

Judgment was entered in this case by the United States Court of Appeals on May 29, 1952. [R. 138.]

## Statement of the Case.

The facts in this case follow a simple pattern. Three individuals owned a navel orange grove which had been held and operated by them or members of their family since 1913. They acquired legal title to the grove on December 31, 1941, upon dissolution of a family corporation. [R. 20, 21, 74.] In May, 1944, they listed the grove for sale with a local real estate broker. [R. 89.] In due course the real estate broker found a purchaser at the original asking price of $197,100.00. [R. 89, 90.] The trees put forth their blossoms in the spring. By approximately July first a crop of green oranges had set on the trees. Beginning in November and continuing into December and January the crop of oranges matured and was picked. [R. 80-82.] The co-owners entered a binding escrow agreement on August 10, 1944, wherein the sale was considered in its entirety as a sale of real estate with farming equipment. On September 1, 1944, the escrow closed and the sellers received a deed to the real property. At the date of the sale the trees had on them the unmature growing crop of oranges. Nowhere in the entire transaction is any mention made of the unmature crop. [R. 78-80, Ex. 5.] Under the established California law the unmature crop passed to the purchaser as part of the real estate. If severed from the trees at the date of sale the green crop would have been worthless. Its sale as picked fruit was prohibited by both federal and state laws. Petitioner, M. Gladys Watson, and her

brothers were in the business of selling picked, ripe fruit (personalty) to eastern buyers through the California Fruit Growers Exchange. [R. 85-88.] They were not in the business of selling unmature fruit on the trees, nor did they ever hold such unmature fruit on the trees for sale. [R. 122, 123.]

Petitioner, M. Gladys Watson, for federal income tax purposes, reported her entire gain from the sale of the grove as capital gain under Section 117(j) of the Internal Revenue Code. The Commissioner determined that an allocation of a portion of the sale price should be made to the unmature fruit and thereupon allocated the sum of $122,500.00 out of the $197,100.00 as the value of the unmature fruit and taxed the petitioner on her portion thereof as ordinary income. [R. 12-13.] The Tax Court upheld the Commissioner in taxing the portion of the proceeds allocated to the unmature fruit as ordinary income, but allocated $40,000.00 of the sale price to the value of the unmature fruit in lieu of $122,500.00. [R. 19-56.] The Court of Appeals for the Ninth Circuit affirmed.

## Specification of Errors.

1. The United States Court of Appeals erred in holding that the unmature fruit was property held primarily for sale to customers in the ordinary course of trade or business, and in failing to hold that the same was real property coming within the purview of Section 117(j) of the Internal Revenue Code.

2. The Court further erred in deciding in the alternative that the holding period of the unmature fruit, commenced when the parties decided to sell the property as a unit, rather than when the property was acquired.

## Summary of Argument.

I. Under the law of the State of California and the law of the vast majority of the states, an unmature, unsevered, growing crop is part of the real property to which it is attached.

II. The unmature oranges were not held by petitioners primarily for sale to customers in the ordinary course of trade or business. The holding period of the crop did not commence at the time the property was listed for sale, but began either on the acquisition date of the land itself or in any event immediately after the old crop was removed, both of which periods are in excess of six months.

III. The holdings of the Courts of Appeals for the Fifth Circuit and for the Tenth Circuit respecting sales of agricultural land with growing crops thereon are in direct conflict with the holding in the Ninth Circuit in the instant case. Uncertainties exist with respect to the application of the federal revenue laws which should be resolved by the decision of the Supreme Court of the United States.

## ARGUMENT.

### I.

### Under the Law of the State of California and the Law of the Vast Majority of the States, an Unmature, Unsevered, Growing Crop Is Part of the Real Property to Which It Is Attached.

The California courts from the earliest times have held that an unmature, unsevered, growing crop of fruit on the trees is a part of the real estate. The decisions of the Supreme Court of California have consistently recognized the peculiar nature of growing crops and have held that they have no independent existence apart from the land to which they are attached and upon which they depend for nutriment. The following California cases support this rule. *Penryn Fruit Co. v. Sherman-Worrell Fruit Co., et al.*, 142 Cal. 643, 76 Pac. 484; *Huerstal v. Muir*, 64 Cal. 450, 2 Pac. 33; *Dascey v. Harris*, 65 Cal. 357, 4 Pac. 204; *Wilson v. White*, 161 Cal. 453, 119 Pac. 895; *Fiske v. Soule*, 87 Cal. 313, 25 Pac. 430; *Young v. Bank of California* (1948), 88 Cal. App. 2d 184, 198 P. 2d 543. The Court of Appeals for the Ninth Circuit assumes in its opinion in the instant case that the unmature fruit was a part of the real property. (197 F. 2d 56, at p. 57.) Nonetheless, the Court holds that such unmature fruit was realty of a different character from the trees and ground which sustained it. Such holding is erroneous as growing crops have no independent existence apart from the land. The California Supreme Court in *Cottle v. Spitzer*, 65 Cal. 456, 4 Pac. 435, states that growing crops are not sufficiently tangible to be treated as property.

## II.

**The Unmature Oranges Were Not Held by Petitioners Primarily For Sale to Customers in the Ordinary Course of Trade or Business. The Holding Period of the Crop Did Not Commence at the Time the Property Was Listed For Sale, but Began Either on the Acquisition Date of the Land Itself or in Any Event Immediately After the Old Crop Was Removed, Both of Which Periods Are in Excess of Six Months.**

Petitioner, M. Gladys Watson, and her brothers sold an orange grove which had been in their family since 1913. They were not attempting to dispose of the unmature crop as such. The sale terminated an enterprise which they had carried on for thirty years. [R. 74.] When the grove was listed for sale in May, 1944, the crop of oranges had not survived the annual June drop. The blossoms and fruit had no measurable value. The original price at which the grove was offered was never changed. [R. 78, 80; 89.] It was evident that the sellers were not attaching any particular value to the crop and were not holding the crop primarily for sale in the ordinary course of their trade or business.

Analogous decisions have held that natural products attached to the land and not in final salable form do not constitute "property held primarily for sale to customers in the ordinary course of trade or business." In *Butler Consolidated Coal Company*, 6 T. C. 183, the Tax Court so held with regard to sale of property containing "coal in place" by one engaged in the business of mining and

selling coal. In *Carroll v. Commissioner*, 70 F. 2d 806, the Court of Appeals for the Fifth Circuit so held with regard to sale of standing timber by one engaged in the business of cutting such timber, sawing it into lumber and selling the lumber.

Petitioner, M. Gladys Watson, and her brothers never previously made a sale of unmature fruit on the trees. In California there were no purchasers of green fruit on the trees in August or September of 1944 or any other year. [R. 122, 123.] At this time the fruit was held only for possible ultimate sale if it finally matured, was picked, packed and shipped to market. It was not held primarily for sale to customers in the ordinary course of trade or business. Consequently, the listing of the grove with real estate brokers would not in any way change the length of the holding period. Until the oranges were mature and severed from the trees and it was actually known that there would be a marketable crop, there was no definite intention to hold the crop for sale as such. The growing crop had no independent existence apart from the land and the holding therefore began at the time the land was acquired in liquidation of the family corporation on December 31, 1941. The holding period of the crop in any event was more than six months. The uncontradicted testimony of the respondent's witness shows that the crop began in December, 1943, or January, 1944, immediately after the old crop was picked, and the sale was made eight or nine months later. [R. 111.]

## III.

**The Holdings of the Courts of Appeals for the Fifth Circuit and for the Tenth Circuit Respecting Sales of Agricultural Land With Growing Crops Thereon Are in Direct Conflict With the Holding of the Ninth Circuit in the Instant Case. Uncertainties Exist With Respect to the Application of the Federal Revenue Laws Which Should be Resolved by the Decision of the Supreme Court of the United States.**

A conflict of decisions exists with respect to the federal income tax liability of sellers who sell agricultural land having upon it an unmature growing crop. A brief review of the three decisions in *McCoy v. Commissioner*, 192 F. 2d 486, *Owen v. Commissioner*, 192 F. 2d 1006, and the case at bar, shows the existence of such conflict. There is no basis for distinguishing the cases upon their facts. In each case the Court holds or assumes that under the applicable local law of Kansas, Florida and California, respectively, that a growing, unsevered crop is real property. In each case the property was sold as a unit and transferred by a deed to the land which conveyed, without separate mention, the trees and growing crops. In each case, with a slight exception in the *Owen* case, the crop was unmature and would have been worthless on the date of sale if severed from the soil which gave it nutriment. The Fifth and Tenth Circuits decided that the growing crop was real property used in the taxpayer's trade or business and held for a period of more than six months within the meaning of Section

117(j) of the Internal Revenue Code. The Ninth Circuit held to the contrary.

In its opinion (197 F. 2d 56, at p. 58) the Court of Appeals for the Ninth Circuit states that the Tenth Circuit in the *McCoy* case ignored the requirement of Section 117(j) of the Code which excludes property "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

At page 59 of the opinion the Court quotes from the case of *Owen v. Commissioner*, and states that this case ignores the requirement of Section 117(j)(1) that the taxpayer must show that the crop was not held for a business sale but for a sale as a unit with the land for more than six months.

The Ninth Circuit in its opinion recognizes that its decision cannot be reconciled to those of the Fifth and Tenth Circuits. Certiorari should be granted so that the conflict of decisions among the Circuits may be resolved.

Petitioners also urge that a writ of certiorari be granted upon the ground that the decision involves an important point of the federal revenue law which is unsettled. Respecting sales of agricultural lands with growing crops, in taxable years ending on or before December 31, 1950, the Commissioner of Internal Revenue is contending that an allocation of the sale price is required, treating the allocation to the growing crop as ordinary income. It should be noted that no attempt was made by the Commissioner of Internal Revenue to tax

unmature crops as ordinary income prior to the Commissioner's ruling *I. T. 3815*, 1946-2 C. B. 30, promulgated in 1946. At the time of the sale in the instant case there was no ruling or attempt on the part of the Commissioner to allocate part of the sale price to unmature crops. For the Commissioner to change such administrative policy at this late date is arbitrary and discriminatory. However, for his position he has support in the decision of the Ninth Circuit in the instant case. On the other hand taxpayers prior to 1946 have reported such sales as sales of capital assets falling within the purview of Section 117(j) of the Internal Revenue Code in their entirety. In so doing taxpayers have been sustained by the Courts of Appeals for the Fifth and the Tenth Circuits.

## Conclusion.

The petitioner, M. Gladys Watson, and her brothers were engaged in the occupation of farming. They were not in the business of selling real estate. Growing crops unsevered from the land are part of the real estate to which they are attached and have no independent existence. The law of the State of California and the common law so hold, as do practically all of the other states of the United States. The disposition of an entire grove with unmature fruit upon the trees does not represent a sale of oranges held primarily for sale to customers in the ordinary course of trade or business. The entire transaction falls within the purview of Section 117(j) of the Internal Revenue Code, as has been decided by

the Courts of Appeals for the Fifth and Tenth Circuits. To hold otherwise is arbitrary and discriminatory. A writ of certiorari should be granted to resolve the conflict between the decisions of those Courts and the decision of the Court of Appeals for the Ninth Circuit. The decision of the Court of Appeals for the Ninth Circuit should be reversed.

Dated: August 22, 1952.

Respectfully submitted,

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## APPENDIX.

### Internal Revenue Code (Title 26, U. S. C. A., Sec. 117.)

Sec. 117(j)(1). Definition of property used in the trade or business.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2.) General rule.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such

gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

Service of the within and receipt of a copy thereof is hereby admitted this.....day of August, A. D. 1952.

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